

The seal of the Office of Regulatory Staff, South Carolina, is a circular emblem. It features a central palmetto tree, a symbol of South Carolina. The words "OFFICE OF REGULATORY STAFF" are written in a circular path around the top half of the tree, and "SOUTH CAROLINA" around the bottom half. In the center, over the trunk of the tree, are the large letters "ORS".

Annual Report on the Status of Local Telephone Competition in South Carolina

Information compiled by the Office of Regulatory Staff

November 2007

Table of Contents

Introduction.....	3
Local Exchange Market	3
Incumbent Local Exchange Carriers.....	4
Competitive Local Exchange Carriers	5
Telecommunications Service Pricing	9
Wireless Carriers	11
Broadband Deployment	14
Consumer Services.....	16
Regulatory Landscape	18
Conclusion	21

Introduction

In order to recognize important changes in the telecommunications industry, the Office of Regulatory Staff (ORS) has been directed by the South Carolina General Assembly (SC Code Ann. Section 58-9-280 amended by Act 318 of 2006) to compile information and monitor the status of local telephone competition in the state. The purpose of this report is to present the status of competition in the local telephone exchange market in South Carolina, to document any major changes that have occurred in the marketplace, and to demonstrate the effect of broadband and wireless services on the competitive local exchange market. This is the second report compiled by the ORS pertaining to this information. Statistics are included for a better depiction of the competitive and incumbent local exchange carriers' market share in South Carolina.

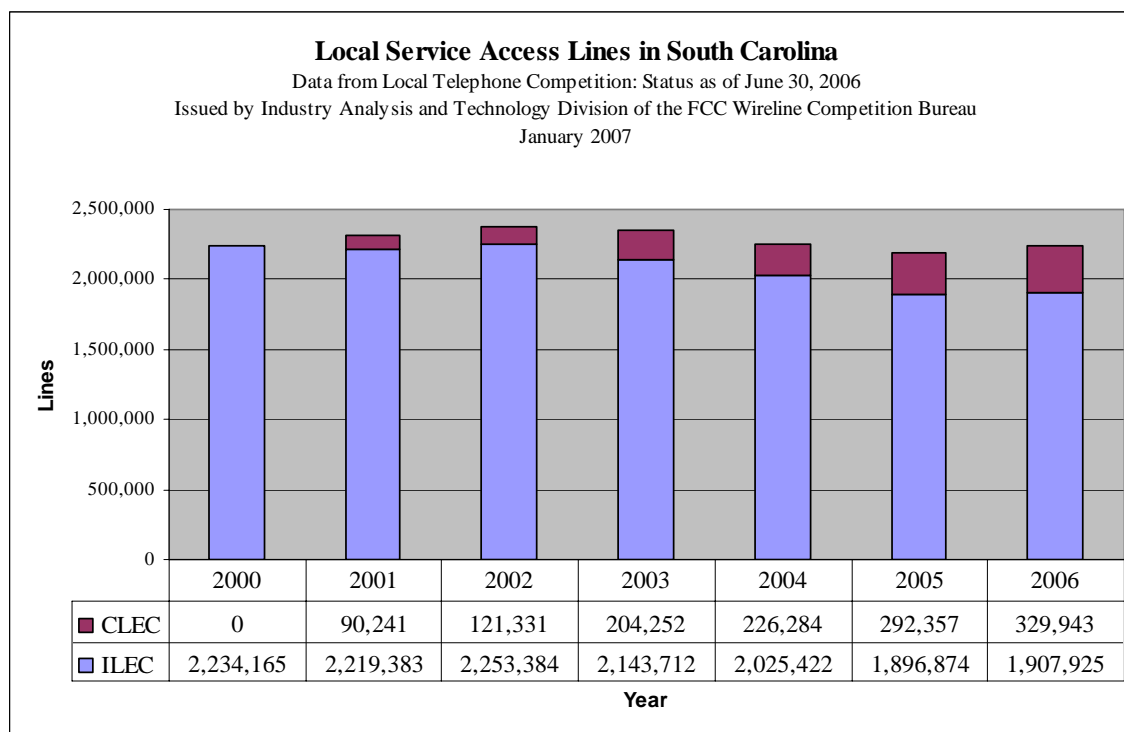
Local Exchange Market

The Local Exchange Market is defined as the market in which local wireline telephone service is provided, and it is measured by the number of access lines or telephone lines delivered. Local exchange services are provided by Incumbent Local Exchange Carriers (ILECs) and Competitive Local Exchange Carriers (CLECs). ILECs are the traditional telephone companies that existed prior to the Federal Telecommunications Act of 1996. CLECs entered the market after 1996 in response to the introduction of competition in the local exchange market through the Telecommunications Act of 1996 enacted by Congress.

Over the last several years the total number of wireline access (telephone) lines has decreased. This trend may be attributed to the increasing number of households

replacing their wireline telephone with a wireless phone or a phone that delivers its service over the Internet. However, Federal Communications Commission (FCC) data from 2006 show a slight change in this trend as the total access lines in South Carolina served by both ILECs and CLECs increased.

Chart 1: Local Service Access Lines



This is the first increase in overall access lines reported by the FCC for South Carolina since 2002. Within the local exchange market, CLECs continue to grow their market share.

Incumbent Local Exchange Carriers

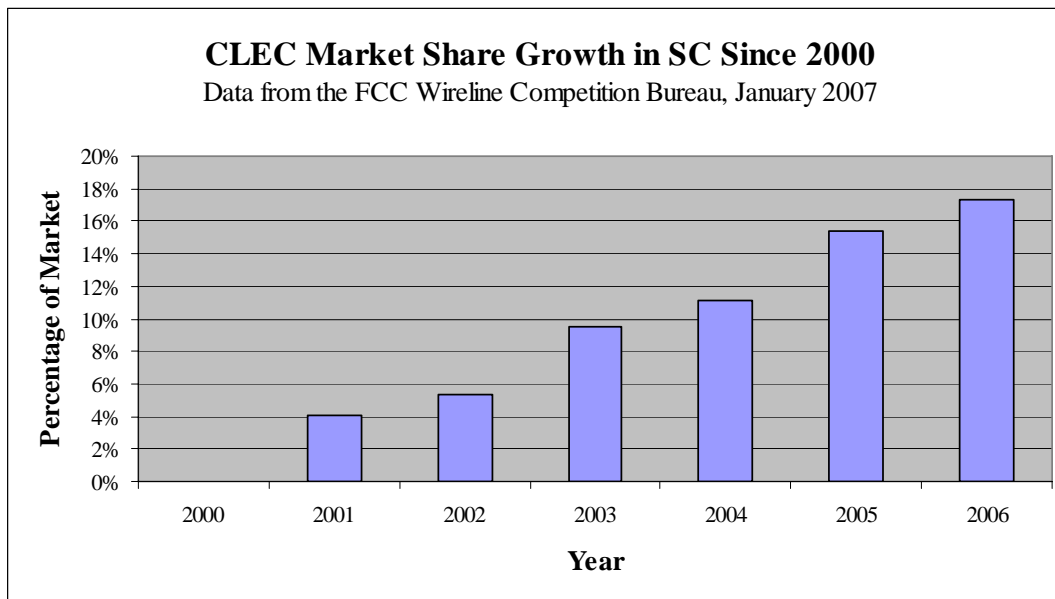
Although 2006 did not bring many changes for the ILECs, two major events occurred. First is the completion of the purchase of South Carolina's largest ILEC, BellSouth, by AT&T. As part of the merger agreement, AT&T agreed to offer

broadband services to 100% of the residential customers in its territory by December 31, 2007. Second, Verizon acquired MCI. The AT&T/BellSouth merger and the Verizon/MCI merger indicate a rebuilding of the large telecommunications companies. Both AT&T and Verizon are major players in both the wireless and wireline market place with AT&T holding the largest share of both.

Competitive Local Exchange Carriers

As relatively new entrants to the market, CLECs have gained almost 18% of the market since 2000. They continued their access line growth in 2006 – increasing from 292,357 access lines in 2005 to 329,943 access lines. This growth was mostly the result of two carriers gaining access lines.

Chart 2: CLEC Market Share Growth



As Table 1 illustrates, South Carolina now has six CLECs with more than 20,000 access lines. This is an increase from the four carriers who reported having more than 20,000

access lines last year and accounts for the majority of the CLEC access-line growth in South Carolina for 2006. One of these CLECs is primarily a cable television provider which offers local- and long-distance telephone services as well as broadband internet services as a bundled package.

Table 1: CLEC Access Lines

2006 CLEC Access Line Distribution in South Carolina			
Number of Lines	2005	2006	2006-% of CLEC Lines
CLECs With No Lines	132	91	0%
CLECs with 1-1,000 Lines	38	39	3%
CLECs with 1,001-10,000 Lines	28	28	26%
CLECs with 10,001- 20,000 Lines	4	2	7%
CLECs with more than 20,000 Lines	4	6	64%
Total Number of CLECs in South Carolina	206	166	

During 2006 and 2007, a number of competitive local exchange carriers exited the local market. Most CLECs rely on the use of the ILECs' networks to provide telecommunications services. Until recently, the most popular and economical method of provisioning competitive services was through the use of Unbundled Network Element (UNE) combinations - specifically, the loop, port, and switching combination of an incumbent carrier's network. These elements were priced pursuant to a forward-looking cost methodology generally referred to as Total Element Long Run Incremental Cost (TELRIC) as defined by the FCC. The prices derived through this methodology were subject to regulatory oversight.

A significant federal policy change occurred in response to federal court action. The policy change eliminated the availability of Unbundled Network Element – Platform (UNE-P) at TELRIC pricing. Incumbent carriers continue to make the network combinations available, but they do so through the use of commercial agreements. In these cases, the pricing of some UNE combinations is no longer based on a cost methodology with regulatory oversight; it is now market-based. The annual increase in prices for UNEs under a commercial agreement is perhaps one of the largest factors contributing to market exit for smaller CLECs. For example, Trinsic cited the elimination of UNE-P by the ILECs as the reason for filing bankruptcy and ultimately exiting the market. Nationally, the National Regulatory Research Institute (NRRI) notes that the “number of CLEC lines...decreased... by June 2006, with at least some of the decrease attributable to the withdrawal of the unbundled switching component at UNE rates under the FCC’s Triennial Review Remand Order.”¹

While the total number of competitive carriers in South Carolina declined from 206 in 2005 to 166 in 2006, CLECs continued to gain access lines and market share.

Alternative Regulation

Prior to the introduction of competition in the telecommunications market, all incumbent local exchange carriers’ prices were regulated based on a study of their rate of return and earnings. With the advent of a competitive telecommunications environment

¹ Ed Rosenberg, Ph.D. Assessing Wireless and Broadband Substitution in Local Telephone Markets. NRRI. June 2007, p. 4.

and the passage of the Telecommunication Act of 1996, the South Carolina General Assembly has passed various forms of regulation for the telecommunications industry. These legislative changes allowed ILECs to be regulated in a more flexible manner if the company could show that competition exists for their services. Over the years, ILECs began to shift to alternative regulation based on the fact that they had interconnection agreements with competitive companies or based on a demonstration of the general availability of wireless services by two or more unaffiliated wireless carriers in their territory. This trend of South Carolina's ILECs moving to the more flexible alternative regulation continued in 2006 and early 2007. Of South Carolina's 25 ILECs, 20 have now elected and qualified for alternative regulation. Nine of those companies cited interconnection agreements as justification for moving to alternative regulation, while the other eleven pointed to wireless service availability as their reason for alternative regulation.

Under this statutory plan, regulatory scrutiny concerning the pricing of services is relaxed. The statutes set out limitations with regard to the pricing of basic local exchange services and cap the amount of revenues which can be realized by increased pricing for services other than local exchange rates. ILECs qualifying for alternative regulation are also allowed to offer packages of bundled services on a non-regulated basis. This pricing flexibility gives carriers the ability to set the price of bundled services competitively with traditionally tariffed services, thus driving consumer demand in the most beneficial direction.

Table 2: Alternative Regulation**ILEC Alternative Regulation Elections, Rural Exemptions, and CLEC Affiliations**

Carrier	Alt. Reg. – Interconnecti on Effective Date	Alt. Reg. – Wireless Effective Date	Rate of Return Regulation	CLEC Affiliate
United Telephone Company of Carolinas (Embarq- formerly Sprint)	29-Sep-97			Embarq Communications, Inc.
BellSouth Telecommunications	13-Aug-99			BellSouth Long Distance
Verizon South, Inc.	14-Oct-00			Verizon South
Windstream South Carolina	27-Sep-02			Windstream Communications
Horry Telephone Coop.	30-Jan-03			HTC Communications, Inc.
PBT Telecom	18-Feb-06			PBT Communications
Home Telephone Co.	7-Apr-06			Home Telecom, LLC
Piedmont Rural Telephone Coop.	12-Jan-07			PRT Communications, LLC
Lockhart Telephone Co.	9-Aug-07			Fairfield Communications
Bluffton Telephone Co.		4-Mar-05		Hargray, Inc.
Hargray Telephone Co.		4-Mar-05		Hargray, Inc.
McClellanville Telephone Co. (TDS)		30-May-05		
Norway Telephone Co. (TDS)		30-May-05		
St. Stephen Telephone Co. (TDS)		30-May-05		
Williston Telephone Co. (TDS)		30-May-05		
Fort Mill Telephone Co. dba Comporium		1-Aug-05		PBT Communications dba Comporium
Lancaster Telephone Co. dba Comporium		1-Aug-05		PBT Communications dba Comporium
Rock Hill Telephone Co. dba Comporium		1-Aug-05		PBT Communications dba Comporium
Chester Telephone Co.		9-Aug-07		Fairfield Communications
Ridgeway Telephone Co.		9-Aug-07		Fairfield Communications
Chesnee Telephone Co.			X	
Farmers Telephone Coop.			X	FTC Diversified
Palmetto Rural Telephone Coop.			X	Palmetto Telephone Communications
Sandhill Telephone Coop.			X	
West Carolina Rural Tel. Coop.			X	West Carolina Communications

Telecommunications Service Pricing:

ILECs – Basic local exchange service rates charged by incumbent local exchange carriers have remained relatively stable in recent years. The major reason for this

pricing stability is that when an ILEC chooses to move to alternative regulation as discussed above, a two-year moratorium is placed on increases on basic service rates. However, some small ILECs - whose basic exchange rates were priced below the statewide average for residential and business rates - have elected to increase those rates to the statewide average rate. Upon pricing basic exchange rates at the statewide average rate, the small carriers are then subject to the statutory two-year moratorium on increases for basic exchange rates.

Only one of the larger local carriers increased their local exchange rates during the review period. The bulk of changes to ILEC rates were predominately increases in what is described by the statute as *Other Services*, which are all services other than basic exchange services. From a retail perspective, these services are generally characterized as discretionary, vertical, or non-basic services such as caller identification, three-way calling, and other custom-calling features. *Other Services* also includes wholesale services which are services required by other carriers to provision local- and long-distance services. A small percentage of the local carrier price changes related to rates for directory assistance and calling plans. Most new tariff activity came from additional service offerings by the ILECs. Data-related offerings such as frame relay and high bandwidth were dominant.

CLECs – Tariff changes were substantial in the CLEC arena. However, applications for entry into the South Carolina market to provide competitive local exchange service tapered off during 2006. As with the ILECs, CLECs introduced new service offerings that should provide more choices to consumers. In addition, rate increases

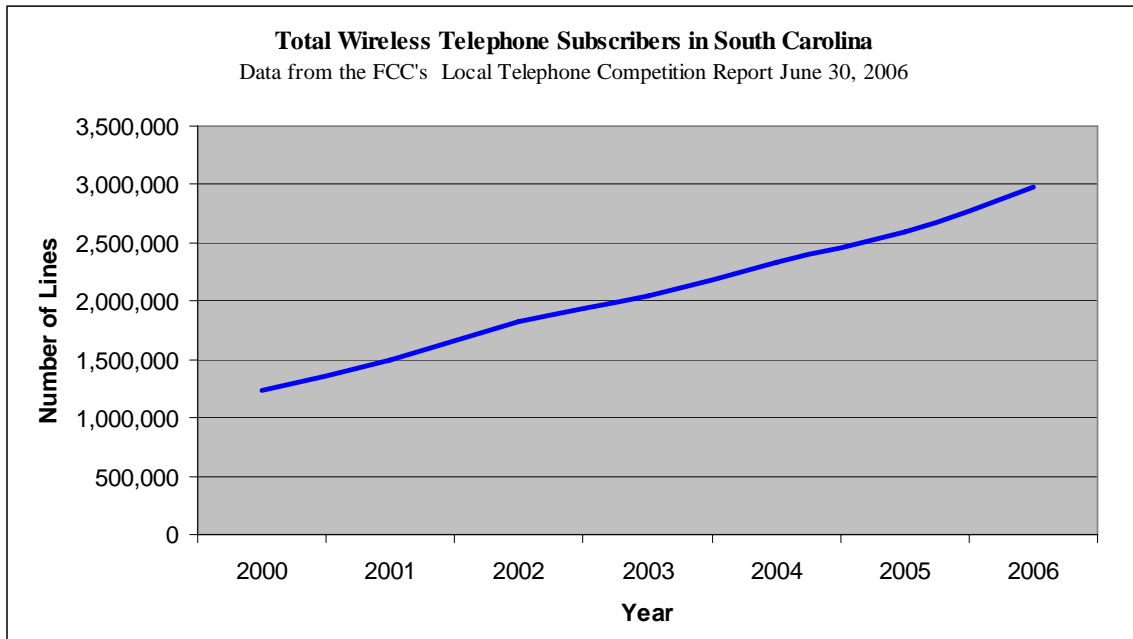
were requested that affected Calling Plans, Vertical Features, Presubscribed Operator Services, and Directory Assistance. Very few changes occurred in the area of Switched Access Service.

IXCs - (Interexchange Carriers), commonly referred to as *Long Distance Providers*, filed a large number of tariff revisions. Like other carriers, the majority of tariff changes were for new service offerings instead of rate changes for existing services. Some of the IXCs which have local affiliates have introduced unlimited calling options that are priced similarly to plans introduced into the market by competitive carriers. Where rate changes were requested, they were predominately increases for both business and residential consumers.

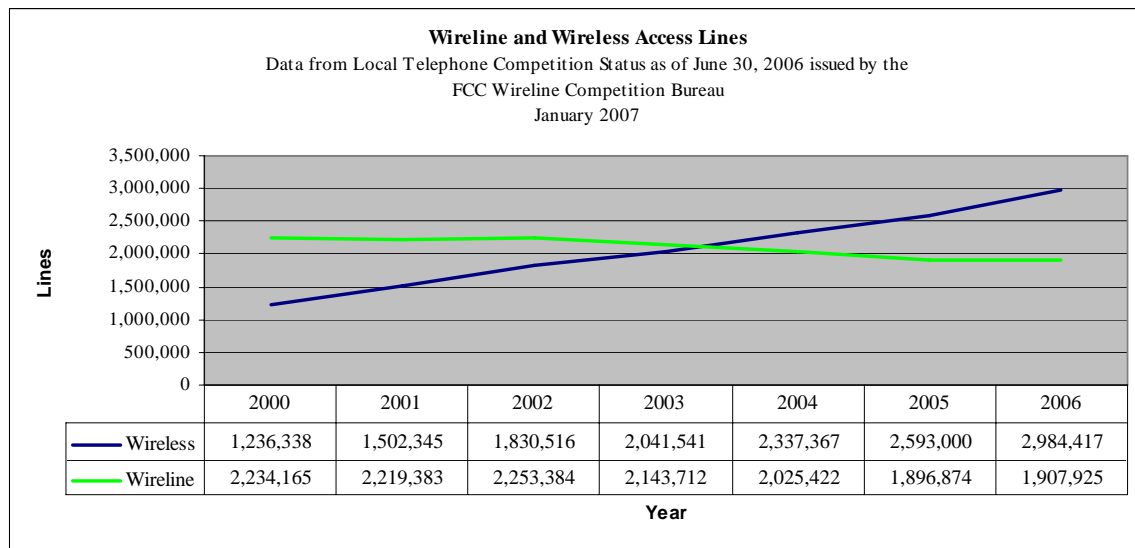
Wireless Carriers

Throughout the country, wireless access lines continue to grow. In 2006, twelve wireless carriers operating in South Carolina reported providing 2,984,417 wireless access lines in this state. To demonstrate the penetration level of wireless services within South Carolina, a comparison of the 2.9 million wireless lines to the total South Carolina population, 4.3 million, indicates that nearly 70% of South Carolina citizens use wireless services. South Carolina currently has approximately 1% of the nation's 217 million wireless lines. Chart 3 shows the steady growth in wireless lines in South Carolina from 2000 to 2006.

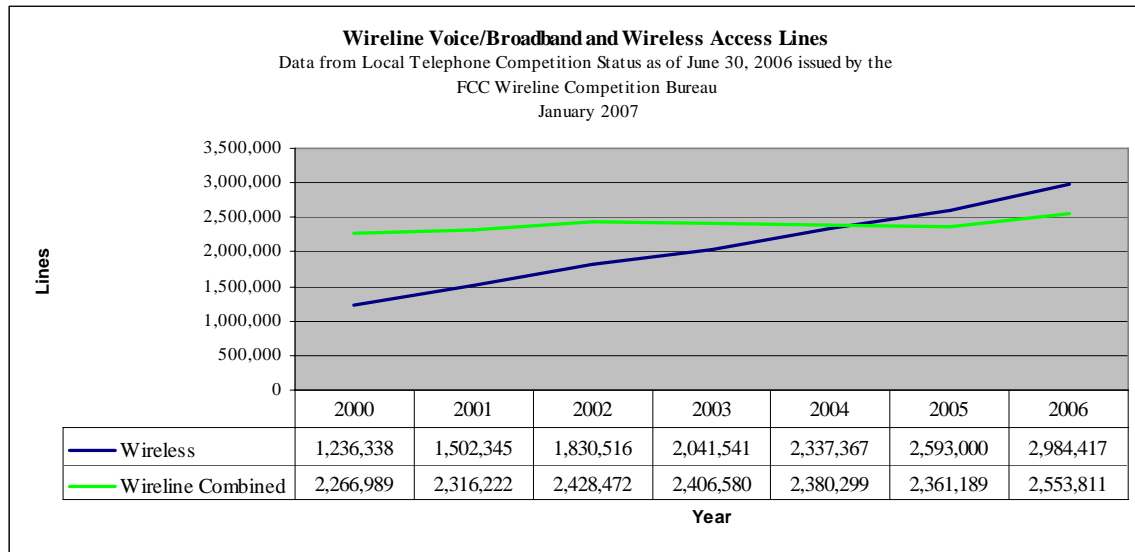
Chart 3: Wireless Subscribers in SC



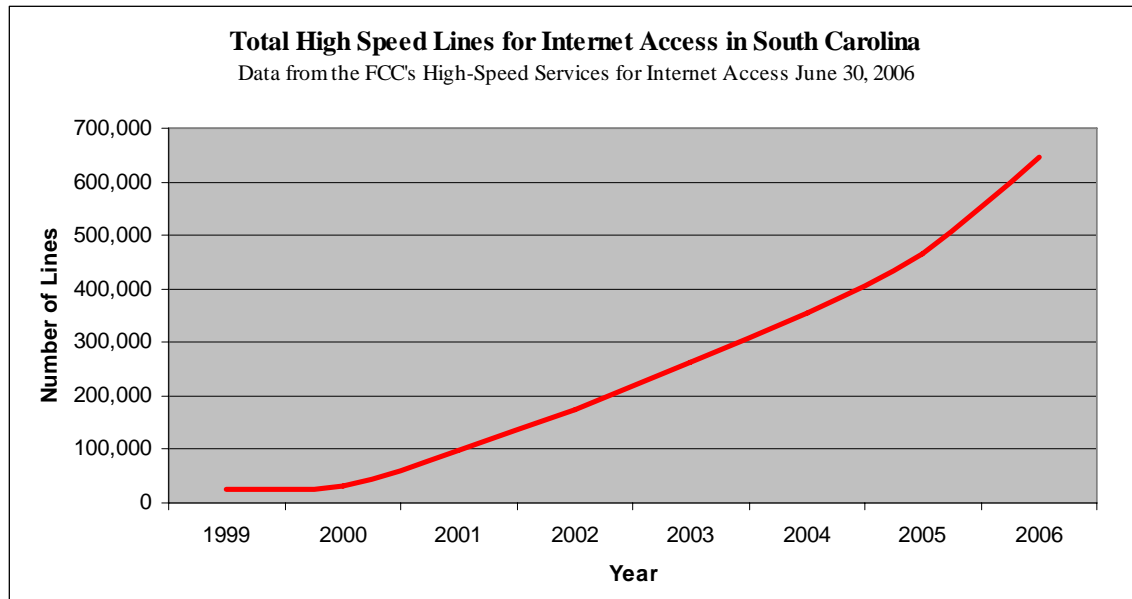
While wireless usage is trending upward, wireline use is declining or flat. These results indicate a continuing tendency of consumers to substitute wireless service for wireline service. Chart 4 tracks a comparison of total wireless and wireline access lines in the state from 2000 to 2006.

Chart 4: Wireline and Wireless

While Chart 4 may suggest wireline carriers are facing declining revenues in comparison to the continued growth of their wireless competitors, market activity indicates that wireline carriers are coupling their traditional voice service with broadband internet service to create additional revenue streams and remain competitive in the market. Chart 5 shows the combination of wireline voice with broadband in comparison to wireless lines. When looking at the data in this manner, the growth of both markets is more comparable. The efficiency of providing broadband and voice traffic over a single line should provide additional stability to the wireline markets. Wireless providers are also looking to continue their deployment of wireless broadband.

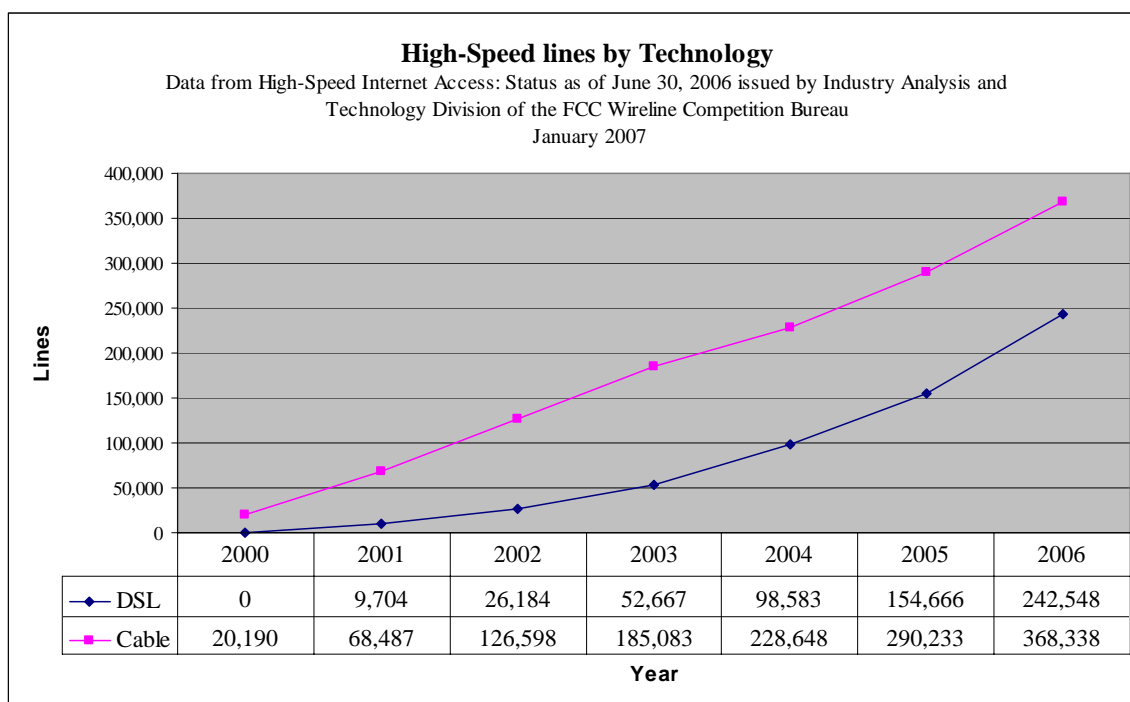
Chart 5: Broadband and Wireless**Broadband Deployment**

Underlying the industrial, technological, and residential growth occurring in South Carolina is the development of enhanced broadband technologies and their deployment throughout the state. As an enabling technology, broadband deployment plays an important role in the economic growth of South Carolina.

Chart 6: Internet Access

Broadband used for internet access continues a steady growth in South Carolina as demonstrated in Chart 6. Over the past 8 years, high-speed lines in South Carolina have grown from 25,229 in 1999 to 645,886 in 2008. Over this period, high-speed lines of 200 kbs or higher have grown by approximately 77,582 lines per year. If this growth continues at the current rate, South Carolina will have over 1 million high-speed access lines in service by 2011.

Broadband is delivered to the customer using two primary technologies: cable modem (offered by cable companies) and Digital Subscriber Line service (DSL) (offered by local exchange carriers). Based on 2006 data, the market share related to these technologies is 368,338 lines for cable modem and 242,548 lines for DSL. Chart 7 shows the growth of high-speed lines by both technologies from 2000 to 2006.

Chart 7: High-Speed Technology

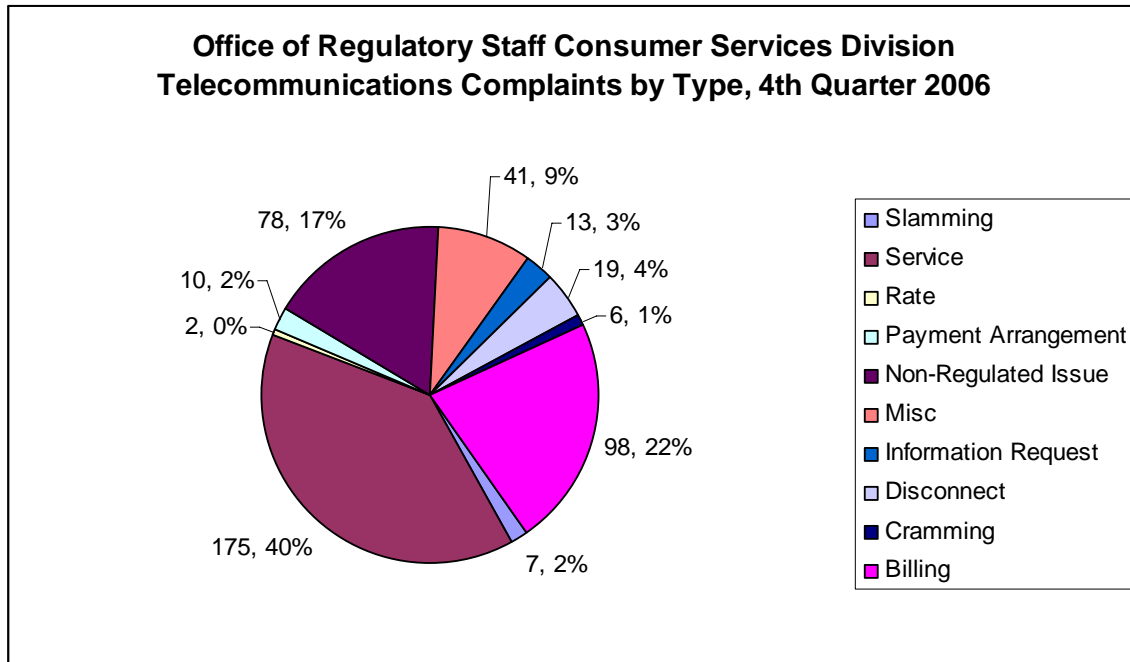
Wireless carriers are beginning to provide a wireless option for high-speed internet access services. In a recent presentation by CTIA, a national wireless carrier association, the presenter indicated that, according to FCC data for the period from December 2005 to June 2006, 59% of new high-speed lines were obtained from Commercial Mobile Radio Service (wireless) providers. Today, wireless operators are aggressively entering the broadband market through enhancement to the wireless network.

Consumer Services

In 2006 consumer complaints continued to focus on service quality, billing issues, and non-regulated issues. The ORS tracked consumer complaints it received during 2006 concerning service, billing, and other issues for both regulated and non-regulated local

telephone services. Chart 8 depicts a categorical breakdown of complaint calls received by the ORS during the fourth quarter of 2006.

Chart 8: Consumer Complaints



Slamming: Unauthorized change of consumer's selected carrier.

Cramming: Placing unauthorized, misleading or deceptive charges on consumers' bills.

Service quality continues to be the largest area of complaints with 40% of the total falling in that category.

Customers are also affected by CLECs abruptly leaving the market. For the most part, CLECs exit the market in an orderly fashion. However, there are occasions when customers suffer termination of service because of CLEC business failures. During 2006, one South Carolina corporation, which served over 10,000 consumers, exited the market abruptly. These situations create significant upheaval for consumers. Consumers are faced with the unfortunate situation of scrambling to find a new telecommunications

service provider. In addition, consumers may lose money paid in advance for services which were not rendered due to the abrupt exit of the carrier from the market.

The Regulatory Landscape

Intercarrier Compensation – Missoula Proposal

Intercarrier compensation is an arrangement in which communications carriers compensate one another for the origination and/or termination of telephone calls. Under the current compensation arrangement, the payments by carriers vary as a function of type of carrier and of service. Because of the evolving landscape of the industry, the FCC recognized a need to consider unification of the current compensation methodologies.

In 2001, through a Notice of Proposed Rulemaking (NOPR), the FCC began working on reform of the intercarrier compensation system. A number of proposals were recommended in response to the NOPR. The FCC issued another NOPR to obtain more specific information on intercarrier compensation in 2005.

The National Association of Regulatory Utility Commissioners (NARUC) established an Intercarrier Compensation Task Force to facilitate participating industry players in developing a new proposal to address intercarrier compensation issues. NARUC filed a proposal with the FCC in July 2006. This latest effort was called the Missoula Plan.

The Missoula Plan is a complex proposal which attempts to address various issues affecting the telecommunications industry. Generally, the Missoula Plan addresses issues related to: 1) preemption of state authority over certain intrastate access rates 2)

compensation reform over a transition period, which includes a reduction of switched access rates with corresponding increases in the subscriber line charges as well as recovery of revenue through a new restructure mechanism 3) interconnection issues and 4) transit and phantom traffic issues. The FCC invited interested parties to file initial comments and reply comments. In addition, the FCC established time frames for interested parties to file separate comments related to phantom traffic issues.

After review of the comments, supporters of the Missoula Plan proposed an amendment to the plan to establish a federal benchmark mechanism; this proposed amendment was intended to address concerns of states that had already dealt with the differential between intrastate and interstate switched access charges. The FCC invited interested parties to file comments on the proposed amendment.

The ORS filed comments on the general Missoula Plan and the Federal Benchmark amendment. Specifically, the ORS expressed concern with components of the plan that would affect how South Carolina implements reduced access charges. South Carolina has enjoyed reduced access charges for many years as a result of the development of the Interim Local Exchange Carriers Fund. Supporters of the plan continue to seek support for a modified Missoula Plan.² As of the date of this report, the FCC has not adopted any proposal.

Designation of Eligible Telecommunications Carriers (ETCs)

Eligible Telecommunications Carriers are carriers who have been designated by the states and, in some cases, the FCC to be eligible to withdraw funds from the federal

² Ed Rosenberg, Lilia Perez-Chavolla and Jing Liu. Intercarrier Compensation and the Missoula Plan Report 06-14. NRRI. October 2006.

Universal Service Fund. Federal law and FCC rules allow both ILECs and CLECs to be designated as ETCs; however, in 2006, only ILECs received this designation in South Carolina. For states that have relinquished jurisdiction of ETC designation to the FCC, the agency has adopted more rigorous requirements for carriers seeking ETC designation and has approved a large number of wireless carriers as ETCs. In general, the FCC set out minimum requirements in its Report and Order, FCC 05-46, which was released in March, 2005. In states such as South Carolina that have retained jurisdiction of ETC designation, the FCC encouraged the adoption of either the FCC's proposed minimum requirements or similar requirements for ETC designation proceedings held at the state level.³

The overall goal of the FCC's revised requirement is to create a more predictable and rigorous designation process to support the long-term sustainability of the federal Universal Service Fund.

South Carolina is one of seven states which did not receive federal USF funds for Competitive Eligible Telecommunications Carriers (CETCs) in 2006. In 2005, CETCs across the nation received a total of approximately \$496 million in high-cost support from the federal USF, with North Carolina receiving approximately \$5 million and Georgia benefiting by over \$7.5 million. South Carolina has yet to receive any federal USF funds for CETCs.⁴ In early 2007, the Federal-State Joint Board on Universal Service Fund recommended to the FCC that an interim cap be placed on the distribution of federal USF monies as a measure to curb the growth of the federal USF. The

³ Order No. 2006-71 Page 3

⁴ Universal Service Monitoring Report 2005, CC Docket No. 98-202-2005, at Table 3.15.

suggested cap was set at the level of funding each state received in 2006. To date, the FCC has not acted on this recommendation; however, should the FCC act in accordance with the Federal-State Joint Board recommendation, South Carolina would not receive funds. Staff from the ORS visited FCC Commissioners and staff in July 2007 to encourage them to make an exemption for the few states like South Carolina who have not drawn any federal USF funding for CETCs.

Conclusion

Based on data the ORS has gathered while investigating the status of local telecommunications competition in South Carolina over the past two reports, the wireless market continues to grow steadily while the landline market share continues to decline, apparently due to wireless substitution. Meanwhile, although the number of CLEC competitors declined in 2006, the remaining CLECs are growing in market share and providing a healthy level of competition.

The major competition for traditional voice telephony in the near future will be the convergence of technologies and platforms. Voice, video and data (broadband) technologies now can be delivered using the same infrastructure, and these services can be offered using either wireline or wireless technologies. As companies try to control the “three screens” of entertainment, computer, and voice communications, new industry alliances will be formed and consumer marketing strategies unveiled.